

# Pension ANALYST

Important Information

Distributions/Withdrawals/Loans

June 2006



## IRS Publishes Revised Final Rules on Disclosure of Relative Values Of Optional Forms of Benefit

**WHO'S AFFECTED** These rules apply to defined benefit plans (including cash balance plans), money purchase pension plans (including target benefit plans), and other defined contribution plans that are subject to the spousal consent rules. Governmental plans and plans sponsored by churches that do not elect to be covered under ERISA (“non-electing church plans”) are not subject to these rules.

**BACKGROUND AND SUMMARY** The IRS originally issued [final rules](#) on relative value disclosures in December 2003. These final rules contained specific requirements for disclosing relative values of all available forms of payment provided under a plan in qualified preretirement survivor annuity (QPSA) and qualified joint and survivor annuity (QJSA) notices. They applied to QPSA notices provided on or after July 1, 2004, and to QJSA notices for distributions with annuity starting dates beginning on October 1, 2004, or later.

On July 1, 2004, the IRS [delayed the effective date](#) of the QJSA notice portion of these regulations to apply to QJSA notices issued for distributions with annuity starting dates on or after February 1, 2006. However, the October 1, 2004 effective date still applied to QJSA notices relating to optional forms of payment that were less valuable than the QJSA form. The disclosure rules still applied to QPSA notices provided on or after July 1, 2004.

On January 28, 2005, the IRS issued proposed rules to formalize this delayed effective date. The proposed rules also clarified that estimates and charts may be used in certain situations to convey relative value information.

On March 24, 2006, the IRS issued revised final rules on relative value disclosures. These revised rules provide that the 2003 rules are generally effective for QJSA explanations with respect to annuity starting dates beginning on or after February 1, 2006. However, a reasonable, good faith effort to comply with the rules will be deemed to satisfy the requirements of the final rules for QJSA explanations provided before January 1, 2007.

This *Pension Analyst* describes the major provisions of these final rules.

**ACTION AND NEXT STEPS** Sponsors of affected plans should review their participant distribution packages and make changes as required by these final rules. If you have any questions about these new rules, please feel free to contact your Prudential Retirement representative.

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Plans that are subject to the spousal consent rules must provide notices to participants and their spouses regarding QPSA and QJSA coverage, as well as any optional forms of benefit provided under the plan. The intent of these rules is to provide enough information to the participant so that he or she can make an informed choice when selecting a form of benefit payment. In general, all qualified defined benefit plans are subject to the notification and spousal consent rules. These rules also apply to defined contribution plans that offer QJSA options.

Recently the IRS issued final rules to adopt and modify the proposed regulations issued in 2005. These final rules also revise the 2003 rules.

## **Reasonable Actuarial Assumptions and Estimates**

Reasonable actuarial calculations must be used to compare the value of an optional form of benefit to the value of the QJSA. The 2006 rules clarify that the reasonableness of interest and mortality assumptions is determined without regard to the circumstances of the individual participant. The applicable mortality table and the applicable interest rate to determine lump sum payments under Internal Revenue Code section 417(e) may be used, but are not required.

The 2006 rules note that a plan may provide generally applicable information using reasonable estimates to determine the amount of normal form of benefit available to a participant. However, the notice must state that a participant may request participant-specific information.

These rules also provide that a QJSA disclosure satisfies the requirements for providing generally applicable information even if the notice contains a participant-specific item instead of generally applicable information.

## **Social Security Level Income Option**

The 2005 proposed regulations noted that plans that offer certain forms of payment that are subject to "417(e)(3)" actuarial assumptions (e.g. single lump sum and years certain installment payments) and that have a lower value than the QJSA, had to comply with the new disclosure rules for payments with annuity starting dates of October 1, 2004, or later. According to these regulations, social security level income forms of payment were subject to the October 1, 2004 effective date. A social security level income option is a payment of a participant's benefit in the form of an annuity with larger payments made in the years before the participant reaches social security retirement age, and lower payments made after social security retirement age, to provide the participant with level retirement income throughout retirement.

The IRS received numerous comments on the 2005 proposed regulations noting that the social security level income option is not subject to the “417(e)(3)” rules. As a result, the IRS deleted this reference from the 2006 final rules agreeing that the 417(e)(3) rules are the appropriate place for guidance on this issue. However, the IRS continues to maintain that “417(e)(3)” disclosure rules apply to this form of payment.

## Definition of Approximately Equal

The 2003 final rules stated that if all forms of payment are approximately equal in value and the information provided to the participant includes a statement to that effect, the plan sponsor does not have to provide specific relative value information. Any optional form of payment that is at least 95% as valuable as the QJSA for a married participant is approximately equal in value to the QJSA. Optional forms of payment can also be disclosed as approximately equal in value to the single life annuity only if all optional forms are within the range of 95% to 102.5% of the value of the single life annuity.

The 2006 revised final rules expanded the 2003 percentages so that all optional forms of payment that have a present value that is at least 95% of the actuarial value of the QJSA and no greater than 105% may be disclosed as approximately equal in value to the QJSA. This rule applies regardless of whether the comparison is made to the QJSA for married participants or the single life annuity for unmarried participants.

## Representative Range

The 2006 final rules permit simplified disclosures of the financial effect and relative value if a plan offers a significant number of “substantially similar” optional forms of payment. If a plan offers a significant number of substantially similar optional forms of payment and the disclosure of these forms would be overwhelming rather than helpful to a participant, then the disclosure can be provided by explaining the relative value and financial effect as a representative range of examples of those optional forms of payment.

*For example, a plan that offers joint and survivor annuity options with survivor payments available in all whole number percentages between 50% and 100%, has substantially similar options.*

A range of examples with respect to substantially similar optional forms of payment is representative only if it includes examples illustrating the relative value and financial effect of the optional forms of benefit that reflect each varying feature at both extremes of its linear range, plus at least one example illustrating the relative value and financial effect of the benefit at an intermediate point.

*For example, a plan offers joint and survivor annuity options with survivor payments available in all whole number percentages between 50% and 100%. All of these optional forms of benefit are approximately equal in value. As a result, the plan may simply disclose the relative value and financial effect of the joint and 50% survivor annuity, the joint and 75% survivor annuity, and joint and 100% survivor annuity.*

However, the disclosure must also provide that a participant can request the financial effect and relative value for any particular optional form of payment.

The final rules confirm that the QJSA notification rules apply to optional forms of payment with retroactive annuity starting dates. As a result, a QJSA disclosure must include relative value and financial effects information for optional forms of payment that are available with retroactive annuity starting dates. The final

rules clarify that plans that offer multiple annuity starting dates may use a representative range of examples to disclose a range of retroactive annuity starting dates.

## **Miscellaneous Items**

The 2006 final rules also clarify that if the plan permits a participant to make separate benefit elections with respect to two or more portions of the participant's benefit, the description of the financial effect and relative values of optional forms of benefit can be made separately for each such portion of the benefit, rather than for each optional form of benefit.

Finally, the revised final rules also confirm that the disclosure of the financial effect of an optional form of benefit must describe the amount and timing of payments during the participant's life and the amount and timing of payments after the participant's death.

## **Effective Dates**

The final rules retain the effective date for QJSA explanations for annuity starting dates on or after October 1, 2004 that apply to disclosures for the following forms of benefit payment, if the value of any of those payment forms is less than the value of the QJSA:

- Single sum payment options;
- Installment payments, such as year certain only (not years certain and life) options; and
- Other decreasing annuities, including certain level income annuity options.

The final rules are generally effective with respect to all other QJSA explanations for distributions with annuity starting dates that occur on or after February 1, 2006. However, the change to disclosures of optional forms of benefit that are approximately equal in value to the QJSA does not have to be applied to QJSA explanations provided before January 1, 2007. Substantial compliance with the 2003 rules will be considered to be a reasonable, good faith effort to comply with the final rules for QJSA explanations provided before January 1, 2007.

The final rules also retain the effective date of July 1, 2004 for QPSA explanations.

## **Next Steps**

Sponsors of affected plans should review their participant distribution packages and make changes as required by these final rules. However, plan sponsors should discuss modifications to these packages and procedures with their ERISA attorneys and, if necessary, the plan's enrolled actuary.

Prudential Retirement is in the process of assessing the impact of these rules on its administrative services and communication packages. We will identify the changes to be made to our forms, notices and procedures. You will be notified when we make those revisions.

If you have any questions about the new rules, please feel free to contact your Prudential Retirement representative.



## Compliance Clips

### **DOL Announces New Mailing Addresses for DFVC Program**

Recently the Department of Labor (DOL) published new addresses for the submission of penalty payments and Forms 5500 under the [DOL's Delinquent Filer Voluntary Compliance Program \(DFVC\)](#). The following new addresses apply to submissions effective April 11, 2006:

**By mail:**

DFVC Program – DOL  
P.O. Box 70933  
Charlotte, NC 28272-0933

**By private delivery service:**

DFVC Program – DOL  
QLP Wholesale Lockbox NC0810  
Lockbox #70933  
1525 West WT Harris Blvd  
Charlotte, NC 28262

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Editor: Mitzi Romano (860) 534-2768